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SUBJECT: Taipei Economic Brief for August 2006

11. This cable summarizes selected recent economic events in Taiwan in August 2006:

- Taiwan firms in China boost economy;
- 419 Microsoft Managers from PRC Attend Taipei Meeting;
- Cross-Strait tourism ready;
- Evergreen rolls out modified 747;
- TSMC sues PRC-based SMIC again;
- Foreign investment exempt from AMT;
- NTD loans designated as FDI.

Industrial Relocation to China Benefits Taiwan Economy

12. Taiwan's four major think tanks all project economic growth will remain around 4% in 2006 and 2007. Taiwan's economy grew 4% in 12005. Export expansion, fueled by production facilities in China, will serve as a major driving force behind Taiwan's economic growth in 2006 and 2007. Taiwan exports to China have grown faster than exports to other markets and have allowed Taiwan to achieve huge trade surpluses and foreign exchange reserves. Export expansion and development of the service sector will keep unemployment in 2006 and 2007 below four percent (except for a seasonal upward fluctuation in summer time). Private consumption and private investment, some 75% of GDP, will gradually recover from the adverse effects of credit/cash card debt and excess inventory problems.

419 Microsoft Managers from PRC Attend Taipei Meeting

13. Taiwan authorities approved a group of 419 China-based Microsoft managers to attend a 3-day meeting in Taipei beginning August 22. The visit reflects efforts to relax restrictions on business trips by white-collar workers from China, one of the 516 recommendations

of the Economic Sustainable Development Conference (ESDC) held in late July. Taiwan's Ministry of Economic Affairs (MOEA) is planning further liberalizations which it expects will facilitate development of regional operations, international logistics, international trade fairs, and related activities in Taiwan. At present, foreign and local companies have set up 305 regional operations headquarters, 89 R&D centers, 12 international warehouses, and nine international logistics centers in Taiwan.

Cross-Strait Tourist Exchanges Are Ready

14. To facilitate tourists from China, Taiwan set up the Taiwan Cross-Strait Tourist Traveling Association (TCTTA) just ten days after the PRC inaugurated the Cross-Strait Travel Exchange Association (CTEA) on August 17. Taiwan's Tourist Bureau (TB) will contribute 50% of the NT\$1 million (US\$30,770) initial funding. TB Director General (DG) Hsu Wen-sheng was elected as TCTTA Chairman, and Deputy DG Lai Seh-jen was appointed as Executive Secretary. Lai will lead Taiwan's delegation in cross-Strait tourist exchange consultations expected to start soon. Once China permits its nationals to travel to Taiwan, Taiwan monetary authorities will allow currency exchange between the NTD and the RMB at designated places near harbors, airports, and sightseeing spots.

Boeing & Evergreen Roll out Modified 747 Freighter

15. Under a Boeing contract, Evergreen Aviation Technologies Corporation (EGAT) rolled out the first of three 747-400 Large Cargo Freighters (LCF) on August 28. The LCF is a 747 specially modified by EGAT to dramatically expand the cargo space to carry the fuselage and wings of Boeing's 787 Dreamliner for final assembly. Boeing and

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EGAT are both pleased by progress so far. The U.S. Federal Aviation Administration has worked closely with the firms to accelerate the certification process for this unusual aircraft. The LCF should begin operations in January 2007. They will be operated exclusively for Boeing's Dreamliner project by Evergreen International Airlines, Evergreen Group's Oregon-based cargo carrier.

TSMC Sues SMIC Again

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16. Taiwan Semiconductor Manufacturing Company (TSMC), the world's largest contract chip maker, announced on August 28 that it was again filing suit against Semiconductor Manufacturing International Corporation (SMIC) of China in a California court. SMIC is TSMC's main rival in the PRC and was founded by Richard Chang, a former TSMC employee. TSMC believes SMIC violated a 2005 settlement and

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continues to use TSMC trade secrets. TSMC had originally filed suit against SMIC in 2003 for patent violations. They reached a settlement in 2005 under which SMIC agreed to pay TSMC US\$175 million.

Taiwan Exempts Foreign Portfolio Investment from 10% AMT

17. In mid-August, Taiwan's Ministry of Finance (MOF) issued an administrative order to exempt foreign institutional investors (FIIs) from the 10% alternative minimum tax (AMT) if the investment capital comes from offshore and is not the FII's own funds. The MOF order will be retroactive to January 1, 2006 when the AMT was implemented. An MOF official estimated that the order will exempt 99% of foreign portfolio investment in Taiwan from the AMT. However, FIIs with fixed offices or agents in Taiwan must pay the AMT for securities trading done for its own account.

NTD Loans Considered Foreign Direct Investment

18. U.S. investment companies could benefit from Taiwan's decision to permit secured NT dollar (NTD) bank loans to be designated as foreign direct investment (FDI). Taiwan's Foreign Investment Commission (FIC) has expanded the permissible sources of FDI to include secured NTD loans provided by Taiwan banks from foreign currency remitted into Taiwan. The foreign investors must be multinational corporations or actually engaged in business activities. "Paper companies" registered with such tax havens as the British Virgin Islands may not enjoy the privilege. However, the Financial Supervisory Commission is concerned that Taiwan companies, particularly banks and other financial institutions, may be vulnerable to hostile takeovers if foreign investors can use local capital obtained from local banks. The move is intended to help absorb excess liquidity in Taiwan's economy.

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